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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION TWO

ANDREW KENNEDY et al.,

Plaintiffs and Appellants,

v.

FARMERS INSURANCE EXCHANGE,

Defendant and Respondent.

B217963

(Los Angeles County
Super. Ct. No. BC407912)

APPEAL from a judgment of the Superior Court of Los Angeles County.
Michael L. Stern, Judge. Reversed and remanded with directions.

Nelson Griffin, Larry R. Nelson, Thomas J. Griffin and Newton Tak for Plaintiffs
and Appellants.

Stone & Hiles and David Schaffer for Defendant and Respondent.

* * * * *

Andrew and Debra Kennedy appeal from a judgment of dismissal following the sustaining of a demurrer without leave to amend their complaint against their automobile liability insurer, Farmers Insurance Exchange, for breach of contract, bad faith, and fraud. We reverse the judgment based on our conclusion that the complaint pleads facts sufficient to state causes of action for breach of contract and insurance bad faith.

FACTUAL AND PROCEDURAL BACKGROUND

On appeal from a judgment of dismissal following a demurrer sustained without leave to amend, we assume the truth of all well-pleaded facts, as well as those that are judicially noticeable, but not contentions, deductions or conclusions of fact or law. (*Howard Jarvis Taxpayers Assn. v. City of La Habra* (2001) 25 Cal.4th 809, 814; *Blank v. Kirwan* (1985) 39 Cal.3d 311, 318.)

Factual Allegations of the Complaint

On July 27, 2004, appellants purchased a six-month-term automobile liability insurance policy from Farmers for their 2000 GMC Yukon, for \$469.40. The policy provided liability coverage of \$100,000 per person per accident. (A copy of the policy is not attached to the complaint.)

On November 17, 2004, while the policy was in effect, appellant Andrew Kennedy was driving the insured vehicle. As he attempted to negotiate a U-turn on Pacific Coast Highway, his vehicle collided with a 1998 Ford pick-up truck driven by Charles Matzdorff.

Matzdorff hired an attorney to represent him on his claim for damages suffered in the traffic accident, including medical expenses and lost earnings. On December 28, 2005, Matzdorff's attorney made a settlement demand to Farmers for the policy limit of \$100,000. Farmers offered \$34,000, which Matzdorff rejected. Appellants were not advised of this settlement demand, nor of Farmers' counteroffer.

On January 6, 2006, Matzdorff filed suit against appellants in the Superior Court of Los Angeles County for bodily injury damages suffered in the collision. Appellants

were served, and on February 13, 2006 they forwarded the summons and complaint to Farmers, which advised them that their defense would be handled by the Law Offices of Early, Maslach & Oelze (EMO). Attorney Mark Snyder of EMO sent a letter to appellants advising them of the following: He would be defending them in the third party action; all attorneys and staff of EMO were salaried employees of Farmers; he would be communicating with Farmers' claims representative; only Farmers could authorize the expenditure of money for defense or settlement; the policy authorized Farmers to settle the third party action within the policy limits without the need for appellants' consent and without any financial contribution by appellants; he would not provide any legal advice concerning any disputes appellants might have with Farmers; and Farmers would not pay for any fees appellants incurred for legal advice concerning a dispute as to coverage.

On February 24, 2006, attorney Snyder sent a case management plan to Farmers, stating that "the case presently appears to involve a clear likelihood of liability on the part of [appellants]," and that "the present full verdict value" and "the settlement value" were "unknown." Snyder was to "determine if [the] case is worth the policy limit, and if not, negotiate a reasonable settlement."

Discovery was conducted in the third party action, and the results were reported to Farmers, but not to appellants. Following Matzdorff's deposition, Snyder wrote to Farmers in a report dated May 26, 2006 that: Matzdorff's testimony was believable and he would make a "good witness" in front of a jury; the collision involved significant impact; after more than a year of treatment, Matzdorff still suffered from pain and neurological problems in his low back and lower extremities, and was a surgical candidate; Matzdorff incurred lost earnings as a landscaper due to his injuries; and a jury was likely to award him some amount of lost income.

Following a defense medical examination, Snyder sent Farmers another report dated July 20, 2006, in which the examining physician concluded that "the accident [was] the sole cause of [Mr. Matzdorff's] . . . symptomatology," that he should be limited in his repetitive lifting to no more than 40 pounds, and that he would benefit from a conventional spinal rehabilitation program estimated to cost \$3,000. On August 29,

2006, following appellants' depositions, another attorney from EMO reported to Farmers that appellants' deposition testimony "tends to support liability" against them, and that there was no evidence of any comparative negligence on Matzdorff's part.

On September 6, 2006, Matzdorff's attorney sent a letter to Snyder requesting that EMO put him in touch with appellants' independent counsel, in light of the conflict created by Farmers' rejection of the policy limit demand, to negotiate the assignment of appellants' rights against Farmers in exchange for an agreement by Matzdorff not to execute on the judgment in the likely event of a jury verdict in excess of the policy limit. This communication was not disclosed to appellants.

The case was then reassigned from Snyder, who had 23 years of legal experience, to attorney Donna Yannotta, who had only three years of experience.

Mediation was held in the third party action on October 3, 2006, at which Matzdorff made a settlement demand of \$750,000. His settlement brief set forth past medical expenses in excess of \$13,000, past lost earnings over \$40,000, and future medical expenses estimated at \$85,000. EMO did not ask appellants to attend the mediation; instead, Maher Habashy of Farmers' California Litigation Center of Excellence attended on appellants' behalf. According to Matzdorff's attorney, Habashy "emphatically stated that Farmers would never offer the policy limit of \$100,000 to settle the third party action." Appellants were not advised of Farmers' position.

On October 12, 2006, Matzdorff's attorney served a statutory offer to compromise in the amount of \$239,000. On November 1, 2006, Habashy spoke with appellant Andrew Kennedy, and asked him to contribute personal assets toward a settlement of the third party action. Appellants explained that they were financially unable to do so. The following day, Habashy sent a letter to appellants stating that Farmers had "just become aware that the potential value of the claims being made against [appellants] could exceed [their] policy limits," and though Farmers would "make every effort" to resolve all claims against appellants within the policy limit, he urged appellants to consult their own legal advisor at their own expense. Habashy did not advise appellants of their right to independent counsel at Farmers' expense pursuant to Civil Code section 2860.

In a 45-day pretrial alert report, dated December 14, 2006, Yannotta reported to Habashy that: Liability was “adverse” to appellants; the likely jury verdict in favor of Matzdorff was “\$250,000–\$350,000”; Matzdorff intended to offer expert testimony from a physician, vocation rehabilitation counselor and an economist, while appellants would only have a medical expert; and “all efforts should be made” to settle the claim within the policy limit.

Trial commenced on January 22, 2007. Yannotta represented appellants at trial. Representatives of Farmers also attended the trial, including Habashy. During the trial, after consulting with Farmers’ representatives, Yannotta told appellant Andrew Kennedy that he “would not have to worry about an excess judgment if they could keep the verdict under \$400,000.” The jury returned a verdict against Andrew Kennedy in the amount of \$300,000. Judgment on the verdict was entered on March 8, 2007, and the notice of entry of judgment was filed on March 12, 2007.

Yannotta “implored” Farmers to pay the entire judgment. By letter dated February 5, 2007, a field claims manager from Farmers’ litigation center encouraged appellants to discuss with Matzdorff’s attorney the possibility of a covenant not to execute on the judgment in consideration of an assignment by appellants of their right to sue Farmers for breach of contract and breach of the implied covenant of good faith and fair dealing. Farmers hired the law firm of Veatch Carlson to represent appellants in these discussions.

On March 23, 2007, Farmers’ coverage counsel tendered a policy limit check for \$100,000 to Matzdorff’s attorney, and expressed his opinion that Farmers was not liable for any part of the judgment in excess of the policy limit.

Appellants were forced to hire counsel “at their own expense” “to protect their rights and pursue the policy benefits wrongfully withheld” by Farmers. Appellants requested Farmers’ and EMO’s complete files. The files they received did not contain Matzdorff’s December 28, 2005 letter making a \$100,000 policy limit demand or his September 6, 2006 letter seeking an assignment of rights in exchange for a covenant not to execute. Appellants believe Farmers intentionally concealed these letters to avoid

liability for any judgment in excess of the policy limit. Had appellants known of these offers, “which would have insulated them from an excess judgment, they would have accepted the offers.”

On April 9, 2007, Matzdorff’s attorney advised appellants’ independent counsel, the law firm of Nelson Griffin, that appellants were responsible for the amount of the judgment in excess of \$100,000, including costs and interest, and that he had researched existing encumbrances on appellants’ home and comparable sales of homes in appellants’ neighborhood, performed a visual inspection of appellants’ home, and concluded that appellants had sufficient equity to satisfy the judgment. He demanded that the judgment be satisfied within seven days. Appellants’ attorney, Thomas Griffin, forwarded the letter to Farmers on April 10, 2007.

When no further payment was received, on April 26, 2007 Matzdorff’s attorney advised appellants’ attorney that he had applied for a debtor’s examination and had taken the preliminary steps to filing an application for a court-ordered sale of appellants’ home. That same day, Griffin advised Farmers that Matzdorff was aggressively pursuing the balance of the judgment, and that Farmers’ refusal to pay the excess judgment left appellants facing a forced sale of their home or foreclosure.

On May 9, 2007, Matzdorff’s attorney advised appellants’ attorney that he had obtained an order for the debtor’s examination of appellant Andrew Kennedy, and that all additional costs incurred to enforce the judgment would be added to Mr. Kennedy’s liability. On May 11, 2007, two months after the verdict was rendered, appellants’ attorney verified that Farmers had finally agreed to satisfy the balance of the judgment. On May 31, 2007, the judgment was extinguished pursuant to stipulation of the parties and the third party action was dismissed.

Causes of Action and Damages

Appellants' complaint against Farmers asserted three causes of action: (1) breach of contract, (2) breach of the implied covenant of good faith and fair dealing, and (3) fraud.¹

Appellants allege that Farmers breached both the insurance policy and the implied covenant of good faith by engaging in the following actions: Unreasonably refusing to pay and withholding insurance benefits for indemnification due upon entry of judgment; making unreasonable demands on appellants to contribute personal funds to settle the third party action without first having offered to pay the policy limit to settle the action; failing to undertake a prompt, full and complete investigation of the third party action to determine the value of the claim in excess of the policy limit; unreasonably refusing to settle the third party claim in excess of the policy limit; concealing settlement offers and the conflict of interest created by rejection of those offers; refusing to provide or offer independent counsel to appellants; misrepresenting to appellants that Farmers would satisfy any judgment under \$400,000; and forcing appellants to file this action to obtain the insurance benefits they are owed.

Appellants allege that Farmers committed fraud in two ways: First, by failing to disclose the December 28, 2005 policy limit settlement demand and the September 6, 2006 proposal of an assignment of rights in consideration of a covenant not to execute, which would have insulated appellants from any excess judgment. Second, by misrepresenting during trial that it would satisfy any judgment under \$400,000. Appellants allege that by such concealments and misrepresentation, Farmers put its own interests ahead of theirs, by preventing appellants from insisting upon their right to independent counsel at Farmers' expense.

¹ The complaint also names Farmers Group, Inc., which, according to Farmers, did not appear in the action and was not dismissed.

Appellants allege that they have sustained “substantial” damages, including attorney fees and costs incurred to secure their insurance benefits, physical injury and emotional distress, and that they are entitled to punitive damages.

The Demurrer, Opposition and Ruling

Farmers demurred to the complaint on the grounds that it failed to state a cause of action for breach of contract or insurance bad faith, that the fraud cause of action was not pled with the requisite specificity, and that the complaint did not allege any recoverable contractual or extra-contractual damages. Appellants opposed the demurrer, arguing that their complaint adequately stated their causes of action and recoverable damages.

At the hearing on the demurrer, appellants sought leave to amend the complaint, but did not specify how they proposed to amend. The trial court sustained the demurrer without leave to amend, concluding: “There’s no breach of contract. The contract call[ed] for them to defend. They defended. That the plaintiffs in this case didn’t like the defense, that they alleged that they suffered a nightmare of litigation . . . doesn’t change the fact that the contract was abided [by] on the face of the complaint.” The court next concluded “there’s no bad faith. . . . Farmers eventually coughed up the \$300,000 payment. So [appellants] got the result that they asked for” Finally, the court concluded “there’s no fraud as alleged. There was no misrepresentation at any time regarding the defense.” As to attorney fees, the court found “those were voluntarily instigated at the present plaintiffs’ request. I don’t find that to be a damage on which emotional distress can be premised for purposes of a bad faith claim.”

Following its order sustaining the demurrer without leave to amend, the court entered judgment in Farmers’ favor. This appeal followed.

DISCUSSION

I. Standard of Review.

We review de novo a trial court’s sustaining of a demurrer, exercising our independent judgment as to whether the complaint alleges sufficient facts to state a cause

of action. (*Zelig v. County of Los Angeles* (2002) 27 Cal.4th 1112, 1126.) We assume the truth of properly pleaded allegations in the complaint and give the complaint a reasonable interpretation, reading it as a whole and with all its parts in their context. (*Stop Youth Addiction, Inc. v. Lucky Stores, Inc.* (1998) 17 Cal.4th 553, 558.) We apply the abuse of discretion standard in reviewing a trial court's denial of leave to amend. (*Blank v. Kirwan, supra*, 39 Cal.3d at p. 318; *Hernandez v. City of Pomona* (1996) 49 Cal.App.4th 1492, 1497–1498.) The plaintiff bears the burden of proving there is a reasonable possibility that the defect can be cured by amendment. (*Blank v. Kirwan, supra*, at p. 318; *Zelig v. County of Los Angeles, supra*, at p. 1126.)

II. The Demurrer Should Be Overruled In Part.

A. Breach of Contract and Bad Faith

As recently explained in *Risely v. Interinsurance Exchange of the Automobile Club* (2010) 183 Cal.App.4th 196, 207 to 208: “A liability insurer has a duty to defend its insured against third party claims that are potentially within the scope of the insured’s policy, and also has a duty to defend any noncovered claims that are asserted in the same action. [Citation.] In addition, the insurer owes the insured a duty to indemnify claims that are covered by the policy. [Citation.] From the duties to defend and indemnify, and the covenant of good faith and fair dealing, California courts have derived an implied duty on the part of the insurer to accept a third party’s reasonable settlement demand on a covered claim in cases in which the insured is facing potential liability in excess of the policy, and the demand is within policy limits. [Citation.]” The basis for this implied duty is as follows: “[A]n insurer is required to act in good faith in dealing with its insured. Thus, in deciding whether or not to settle a claim, the insurer must take into account the interests of the insured, and when there is a great risk of recovery beyond the policy limits, a good faith consideration of the insured’s interests may require the insurer to settle the claim within the policy limits. An unreasonable refusal to settle may subject the insurer to liability for the entire amount of the judgment rendered against the insured,

including any portion in excess of the policy limits.’” (*Hamilton v. Maryland Casualty Co.* (2002) 27 Cal.4th 718, 724–725.)

“[T]he scope of the duty imposed upon the insurer by the implied covenant of good faith and fair dealing does not turn on whether its breach is characterized as contractual or tortious because, in either case, the duty itself springs from the contractual relationship between the parties. [Citation.] Put another way, an insurer’s breach of the implied covenant of good faith and fair dealing constitutes what is commonly called ‘bad faith.’ Whether the insured’s remedy will be in contract or tort will depend on the nature of the relief or recovery sought by the insured.” (*Archdale v. American Internat. Specialty Lines Ins. Co.* (2007) 154 Cal.App.4th 449, 466.)

Appellants’ complaint does not differentiate between the causes of action for breach of contract and bad faith in that it uses the same actions by Farmers to constitute both claims. Farmers contends that because it assigned counsel to defend appellants and ultimately paid the policy limit, plus the excess portion of the judgment, it satisfied its express and implied duties to appellants. But at this stage of the pleadings, we cannot make that determination as a matter of law.

The complaint alleges that Farmers never communicated to appellants Matzdorff’s December 28, 2005 initial demand for the policy limit or the September 6, 2006 attempt by his attorney to contact appellants’ independent counsel to explore an assignment and agreement not to execute. At this point, appellants did not have independent counsel. Although Farmers later assigned them independent counsel following the trial to negotiate the proposed assignment of rights and covenant not to execute, it did not do so at the time the proposal was first made. An argument can be made that Farmers had the duty to assign appellants independent counsel when the proposal was first made. (Civ. Code, § 2860, subd. (a).) Indeed, the inference can certainly be made that a conflict was apparent even to a third party, when Farmers refused to settle for the policy limit.

While the complaint does not indicate whether appellants were made aware of Matzdorff’s \$750,000 demand at the mediation, it is clear they were not informed by Farmers that it had taken the position at this mediation that it would never pay the policy

limit. Moreover, according to the complaint (the allegations of which we must accept as true for purposes of a demurrer) appellants were not informed until after Matzdorff's \$239,000 statutory offer to compromise that Farmers believed the potential value of his claims could exceed the policy limit. A liability insurer has a duty to communicate to the insured any settlement offer that could affect the insured's interests (e.g., a settlement demand exceeding the policy limits) in order to allow the insured an opportunity to contribute to the settlement. (*Heredia v. Farmers Ins. Exchange* (1991) 228 Cal.App.3d 1345, 1360.) A trier of fact could reasonably find that Farmers' failure to communicate Matzdorff's offers to appellants constituted a breach of the duty to defend and/or bad faith.

Our Supreme Court has explained that "the only permissible consideration in evaluating the reasonableness of the settlement offer becomes whether, in light of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the settlement offer." (*Johansen v. California State Auto Assn. Inter-Ins. Bureau* (1975) 15 Cal.3d 9, 16.) Determination of the reasonableness of a settlement offer is based on the information available to the insurer at the time of the proposed settlement. (*Isaacson v. California Ins. Guarantee Assn.* (1988) 44 Cal.3d 775, 793.)

It is unclear from the complaint exactly what information Farmers had at the time Matzdorff made his initial policy limit demand one year after the accident. But by early November 2006, Farmers knew the potential value of Matzdorff's claims could exceed the policy limit. Additionally, in her 45-day pretrial alert report to Farmers, dated December 14, 2006, Yannotta explained that liability was adverse to appellants, that Matzdorff intended to offer multiple expert witnesses at trial, and that a likely jury verdict in his favor would be in the range of \$250,000 to \$300,000, well beyond the policy limit. Although Yannotta urged Farmers in this report to make all efforts to settle the third party claim within the policy limit, Farmers did not do so, and instead allowed the case to proceed to trial.

Farmers argues that even assuming it could be found to have unreasonably refused to settle the third party action within the policy limit, appellants cannot show that they suffered any compensable damages. “An essential element of a cause of action for breach of the implied covenant based on the refusal to settle is resulting damages.” (*Wolkowitz v. Redland Ins. Co.* (2003) 112 Cal.App.4th 154, 162.) “Damages ordinarily include the entire amount of a judgment after trial, including the amount in excess of policy limits but excluding any punitive damages.” (*Ibid.*; *Hamilton v. Maryland Casualty Co.*, *supra*, 27 Cal.4th at p. 726.) Farmers claims that because it ultimately paid the full amount of the judgment entered against appellant Andrew Kennedy, including the amount in excess of the policy limit, appellants cannot show that they suffered any economic loss.

The complaint alleges that appellants were forced to hire “at their own expense” independent counsel “to prevent Farmers from placing its interests ahead of [appellants] with respect to the third party action and as a result of efforts to secure the insurance benefits owed [appellants].” When an “insurer’s tortious conduct reasonably compels the insured to retain an attorney to obtain the benefits due under a policy, it follows that the insurer should be liable in a tort action for that expense.” (*Brandt v. Superior Court* (1985) 37 Cal.3d 813, 817.) Farmers points out that “[f]ees attributable to obtaining any portion of the plaintiff’s award which exceeds the amount due under the policy are not recoverable.” (*Id.* at p. 819; *Essex Ins. Co. v. Five Star Dye House, Inc.* (2006) 38 Cal.4th 1252, 1258 [“In a tort action for wrongful denial of policy benefits, *Brandt* allows the insured to recover as tort damages only the attorney fees incurred to obtain the policy benefits wrongfully denied. [Citation.] But attorney fees expended to obtain damages exceeding the policy limit or to recover other types of damages are not recoverable as *Brandt* fees”].)

Farmers argues that because appellants retained independent counsel after it had tendered the \$100,000 policy limit to Matzdorff, appellants did not incur attorney fees to obtain policy benefits that were wrongfully withheld. Rather, they incurred fees to persuade Farmers to pay the portion of the judgment exceeding the policy limit, and

under *Brandt* such fees are not recoverable in a bad faith action. But Farmers ignores that its failure to explore settling the third party action within the policy limit prior to trial and certainly after it knew that liability could exceed the policy limit, as well as its failure to keep appellants informed of Matzdorff's various settlement demands and offers, exposed appellants to potential liability beyond the policy limit.

"In cases in which the insured faces potential liability beyond the policy limits of the defending insurer's policy, courts have concluded that an insured can demonstrate that he has suffered damages from an insurer's breach of the duty to defend, apart from defense costs, in the form of exposure to personal liability." (*Risely v. Interinsurance Exchange of the Automobile Club, supra*, 183 Cal.App.4th at p. 215.) Although *Risely* was issued while this appeal was pending and was first cited in appellants' reply brief, we note that it relied on older cases for this proposition, including *Ringler Associates Inc. v. Maryland Casualty Co.* (2000) 80 Cal.App.4th 1165, 1187. "As the *Ringler* court suggested, one of the primary considerations in determining whether the insured received a full and complete defense, notwithstanding the insurer's breach, is whether the breach exposed the insured to additional potential liability." (*Risely v. Interinsurance Exchange of the Automobile Club, supra*, at p. 215.) Thus, we cannot conclude as a matter of law that appellants suffered no economic loss.

Appellants also seek to recover emotional distress damages. Farmers argues that because appellants cannot show they suffered economic loss, they cannot recover emotional distress damages. "Courts have stated that plaintiffs need to make a 'threshold' showing of some financial loss in order to recover emotional distress damages at all. . . . This is because . . . in the insurance bad faith setting, emotional distress is not recoverable as a separate cause of action, but only as "an aggravation of the financial damages." (Major v. Western Home Ins. Co. (2009) 169 Cal.App.4th 1197, 1215–1216; Maxwell v. Fire Ins. Exchange (1998) 60 Cal.App.4th 1446, 1450 ["We hold that the emotional distress damages which appellant seeks are not recoverable in a bad faith action arising out of a third party claim absent a showing that appellant has suffered an economic loss"]; Continental Ins. Co. v. Superior Court (1995) 37 Cal.App.4th 69, 86

[“In the absence of any economic loss there is no invasion of [the insureds’] *property rights* to which their alleged emotional distress over [the insurer’s] denial and delay could be incidentally attached. In short, there would be no legal basis for an action for bad faith”]; *Gourley v. State Farm Mut. Auto. Ins. Co.* (1991) 53 Cal.3d 121, 128 [“the bad faith action is not a suit for personal injury, but rather ‘relates to financial damage’”].)

Because we conclude that appellants may be able to establish economic loss, we cannot rule out the possibility at this point in the litigation that they are entitled to emotional distress damages.

Accordingly, we conclude that the trial court improperly sustained the demurrer to the first and second causes of action, and that the judgment of dismissal therefore should be reversed.

B. Fraud

The elements of a fraud cause of action are (1) misrepresentation of a material fact, (2) knowledge of falsity, (3) intent to defraud, (4) justifiable reliance upon the misrepresentation, and (5) damage resulting from the justifiable reliance. (*Stansfield v. Starkey* (1990) 220 Cal.App.3d 59, 72–73.) Active concealment of a material fact has the same legal effect as that of an affirmative misrepresentation. (*Stevens v. Superior Court* (1986) 180 Cal.App.3d 605, 609; *Outboard Marine Corp. v. Superior Court* (1975) 52 Cal.App.3d 30, 37 [“Fraud or deceit may consist of the suppression of a fact by one who is bound to disclose it or who gives information of other facts which are likely to mislead for want of communication of that fact”].) “In order to recover for fraud, as in any other tort, the plaintiff must plead and prove the ‘detriment proximately caused’ by the defendant’s tortious conduct. (Civ. Code, § 3333.) Deception without resulting loss is not actionable fraud. [Citation.]” (*Service by Medallion, Inc. v. Clorox Co.* (1996) 44 Cal.App.4th 1807, 1818; *Gold v. Los Angeles Democratic League* (1975) 49 Cal.App.3d 365, 374 [“To state a cause of action at law based upon fraud . . . , the plaintiff must allege not only reliance but that, by reason of the fraud, he has suffered pecuniary damage in some amount”].)

Appellants rely on the same conduct by Farmers to support their fraud cause of action as that used to support their bad faith claim, namely that Farmers (1) concealed Matzdorff's pre-suit policy limit demand and the subsequent proposal by his attorney that appellants assign their rights against Farmers in return for a covenant not to execute; and (2) misrepresented during trial that appellants would not have to worry about any judgment under \$400,000.

Conduct by an insurer that might arguably constitute bad faith does not necessarily constitute fraud. The complaint alleges that Farmers made the concealments before trial and the misrepresentation during trial with the intent to defraud appellants by preventing them "from insisting upon their right to independent counsel, resulting in an economic benefit to Farmers." But there are no factual allegations in the complaint to support this conclusion or from which this inference may be drawn. Indeed, Farmers did ultimately assign appellants independent counsel, albeit belatedly, to negotiate an assignment and covenant not to execute. And Farmers did ultimately pay the full judgment, which was under \$400,000, such that appellants cannot plead misrepresentation of a material fact. The absence of any one of the elements of fraud is generally fatal to recovery. (*Goldstein v. Enoch* (1967) 248 Cal.App.2d 891, 895; *Rakestraw v. California Physicians' Service* (2000) 81 Cal.App.4th 39, 43 ["Because a demurrer tests the legal sufficiency of a complaint, the plaintiff must show the complaint alleges facts sufficient to establish every element of each cause of action. If the complaint fails to plead, or if the defendant negates, any essential element of a particular cause of action, this court should affirm the sustaining of a demurrer"].)

Accordingly, the trial court properly sustained the demurrer to the third cause of action on the ground that the complaint fails to state a claim for fraud.

III. Unpled Causes of Action.

Appellants are correct that "we are not limited to plaintiffs' theory of recovery in testing the sufficiency of their complaint against a demurrer, but instead must determine if the *factual* allegations of the complaint are adequate to state a cause of action under

any legal theory.” (*Barquis v. Merchants Collection Assn.* (1972) 7 Cal.3d 94, 103.)

“Reversible error exists only if facts were alleged showing entitlement to relief under any possible legal theory.” (*Hernandez v. City of Pomona, supra*, 49 Cal.App.4th at p. 1497.)

On appeal, appellants contend that their complaint alleges facts sufficient to show their entitlement to relief under three unpled causes of action: (1) Negligent misrepresentation; (2) intentional interference with prospective economic advantage; and (3) negligent interference with prospective economic advantage. We disagree.

A. *Negligent Misrepresentation*

“Negligent misrepresentation is a form of deceit, the elements of which consist of (1) a misrepresentation of a past or existing material fact, (2) without reasonable grounds for believing it to be true, (3) with intent to induce another’s reliance on the fact misrepresented, (4) ignorance of the truth and justifiable reliance thereon by the party to whom the misrepresentation was directed, and (5) damages.” (*Fox v. Pollack* (1986) 181 Cal.App.3d 954, 962.)

Appellants base their unpled negligent misrepresentation cause of action on the same statement that forms the basis of their fraud cause of action, i.e., that Farmers misrepresented during trial that it would pay any judgment under \$400,000. Because Farmers did ultimately pay the full amount of the judgment, this cause of action fails for the same reason appellants’ fraud cause of action fails—appellants cannot plead the required element that a misrepresentation of a material fact was made.

B. *Interference with Prospective Economic Advantage*

The elements of a cause of action for intentional interference with prospective economic advantage are: “(1) an economic relationship between the plaintiff and some third party, with the probability of future economic benefit to the plaintiff; (2) the defendant’s knowledge of the relationship; (3) intentional acts on the part of the defendant designed to disrupt the relationship; (4) actual disruption of the relationship;

and (5) economic harm to the plaintiff proximately caused by the acts of the defendant.” (*Youst v. Longo* (1987) 43 Cal.3d 64, 71, fn. 6.)

“The tort of negligent interference with prospective economic advantage is established where a plaintiff demonstrates that (1) an economic relationship existed between the plaintiff and a third party which contained a reasonably probable future economic benefit or advantage to plaintiff; (2) the defendant knew of the existence of the relationship and was aware or should have been aware that if it did not act with due care its actions would interfere with this relationship and cause plaintiff to lose in whole or in part the probable future economic benefit or advantage of the relationship; (3) the defendant was negligent; and (4) such negligence caused damage to plaintiff in that the relationship was actually interfered with or disrupted and plaintiff lost in whole or in part the economic benefits or advantage reasonably expected from the relationship.” (*North American Chemical Co. v. Superior Court* (1997) 59 Cal.App.4th 764, 786.) As with claims for intentional interference, an essential element of the tort of negligent interference is an independently wrongful act. (*National Medical Transportation Network v. Deloitte & Touche* (1998) 62 Cal.App.4th 412, 440.)

Appellants base their unpled causes of action for intentional and negligent interference with prospective economic advantage on the pretrial letter from Matzdorff’s attorney proposing an assignment of appellants’ rights in exchange for a covenant not to execute. But appellants cannot state a cause of action for interference on the basis of this offer for the simple reason that they and Matzdorff were not in an economic or business relationship at the time the offer was made, let alone a relationship which carried the probability of future economic benefit to appellants. To the contrary, they were opposing parties with adversarial interests in a personal injury lawsuit. “The tort of intentional or negligent interference with prospective economic advantage imposes liability for improper methods of disrupting or diverting the business relationship of another which fall outside the boundaries of fair competition. [Citation.] It is premised upon the principle, “everyone has the right to establish and conduct a lawful business and is entitled to the protection of organized society, through its courts, whenever that right is

unlawfully invaded.””” (Settimo Associates v. Environ Systems, Inc. (1993) 14 Cal.App.4th 842, 845.)

This was not a situation where appellants and Matzdorff had already entered into a settlement between themselves or where appellants had agreed to assign their rights to Matzdorff in exchange for a covenant not to execute and Farmers then engaged in some independently wrongful act that interfered with the parties’ agreement. Indeed, appellants were unaware of the proposal at the time it was made.

Accordingly, the complaint does not state causes of action for intentional or negligent interference with prospective economic advantage.

DISPOSITION

The judgment of dismissal is reversed. The trial court is directed to enter a new order overruling the demurrer as to the first and second causes of action for breach of contract and bad faith. Appellants are entitled to their costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS.

_____, J.

DOI TODD

We concur:

_____, P. J.

BOREN

_____, J.

ASHMANN-GERST